CITY COUNCIL MEETING AND WORKSHOP
AGENDA STATEMENT

ITEM: ___________

MEETING DATE: 5/19/04

ITEM TITLE: Resolution __________ Of The City Council Of The City Of Chula Vista To:

A) Accept The Municipal Energy Utility Feasibility Report And Peer Review Analysis Reports.
B) Direct Staff To Return To Council By June 8, 2004 For Further Consideration Of The Consultant's Recommendation To Implement City Municipal Energy Utility Business Models.
C) Direct Staff To Prepare and distribute A "Request For Proposal" For A Full-Requirement Greenfield Development And Community Choice Aggregation Service Provider And Return To Council For Further Action.
D) Direct Staff To Continue To Work With The California Public Utilities Commission To Assert The City's Position Regarding The Development Of Community Choice Aggregation Rules, Exit Fees And Municipal Departing Load Fees.
E) Direct Staff To Continue To Work With SANDAG To Implement Regional Energy Options.
F) Direct Staff To Continue To Actively Monitor And Influence Pending and New California Public Utilities Commission, California Energy Commission, State and Federal Energy Rules And Legislation.

SUBMITTED BY: Assistant City Manager

REVIEWED BY: City Manager **(4/5ths Vote: Yes X No)**

INTRODUCTION:

At Council's direction, Staff began implementing the City's Energy Strategy and Action Plan, adopted in May of 2001. To date, on-going energy conservation programs are being implemented, City facilities are renovated and built to exceed state energy efficiency requirements and renewable power is being installed on some City facilities.

A significant aspect of the Strategy requires an analysis of the costs, benefits and risks associated with forming and operating a municipal energy utility (MEU). The purpose of the City of Chula Vista Municipal Energy Utility Analysis is to identify and evaluate the potential for a municipal energy utility to 1) better control the City's energy future, 2) provide stable rates for customers, 3) enhance local control of conservation funds, 4) generate new city revenues, 5) enhance city services, 6) catalyze economic development opportunities, 7) mitigate the local environmental impacts of energy generation and distribution, 8) fund renewable energy projects and 9) generate quality local jobs.

The results of the analysis by Duncan/Navigant indicate that there are legally, financially and technically feasible MEU models that the City should pursue. These MEU models, which are defined in detail below, include Community Choice Aggregation (CCA), Greenfield Development (GD) and Municipal Distribution Utility (MDU).

The MEU models are viable as independent business models and can provide maximum benefits to the City when a phased implementation approach is carried out. The MEU business models are viable using a “contract” supply strategy for electricity procurement and become even more financially feasible using “locally owned generation” as an electricity supply strategy.

There are significant start-up, and on-going, costs as well as risks associated with implementing each City MEU business model. However, the cost/benefit analysis conducted by the consultants takes these costs into account when determining financial viability, and these risks can be mitigated by implementing the most successful business practices already used by the approximately 38 existing California and almost 2000 U.S. public utilities.

To test and validate the consultant team’s findings, conclusions and recommendations, Staff retained the peer review services of three independent energy consultants. This report provides a summary of the review findings from R.W. Beck (Attachment 1). Crossborder Energy (Attachment 2) and Tabors, Caramanis and Associates (Attachment 3). Also attached to this Staff report are the MEU Report Executive Summary (Attachment 4), Report (Attachment 5), the Appendices (Attachment 6), and the March 25, 2003 Council Agenda Statement selecting Duncan/Navigant (Attachment 7).

RECOMMENDATION: That Council:

1. Accept The Municipal Energy Utility Feasibility Report And Peer Review Analysis Reports.
2. Direct Staff To Return To Council By June 8, 2004 For Further Consideration Of The Consultant’s Recommendation To Implement City Municipal Energy Utility Business Models.
3. Direct Staff To Prepare and distribute A “Request For Proposal” For A Full-Requirement Greenfield Development And Community Choice Aggregation Service Provider And Return To Council For Further Action.
4. Direct Staff To Continue To Work With The California Public Utilities Commission And Other State Agencies To Assert The City’s Position Regarding The Development Of Community Choice Aggregation Rules, Exit Fees And Municipal Departing Load Fees.
5. Direct Staff To Continue To Work With SANDAG To Implement Regional Energy Options.
6. Direct Staff To Continue To Actively Monitor And Influence Pending and New California Public Utilities Commission, California Energy Commission And State Energy Rules And Legislation.

BOARDS/COMMISSIONS RECOMMENDATION:

Not applicable.

BACKGROUND:

In 1996 Governor Wilson signed AB 1890, putting California on course for energy deregulation. The projected benefits of deregulation were never realized, instead San Diego Gas and Electric (SDG&E) customers' bills dramatically increased, beginning in May 1999. Soon after, Pacific Gas and Electric and Southern California Edison warned the state of their impending bankruptcies and their lack of financial worthiness to continue buying power for customers. In 2000 and 2001, SDG&E customers experienced brownout alerts and blackouts due to lack of power supply and market manipulation by the energy Industry. In early 2000, Governor Davis signed AB 1X into law authorizing the Department of Water Resources to begin buying power to serve California's energy needs. In January 2003, the regulated, Investor Owned Utilities (IOU) were directed to resume purchasing power for customers.

In August 2000 Council directed Staff to investigate any and all energy options that the City could pursue to potentially protect Chula Vista residential and commercial ratepayers from exponential rate increases, and better position the City, to deal with the volatility and uncertainty of the energy market. In April 2001, following a Council workshop outlining the City's options, Council directed Staff to return with the implementing resolution adopting a City Energy Strategy and Action Plan. In May 2001 Council passed Resolution No. 2001-162 adopting the City's Energy Strategy and Action Plan (please see Attachment 7). Included was a recommendation that the City take the initial steps to assess the costs and benefits of forming and operating a municipal utility. On June 5 Council passed Ordinance No. 2835 establishing the City's status as a Municipal Utility, and directing Staff to conduct a cost-benefit analysis of the various energy business models that could be used to operate a municipal utility. In addition, to assessing the cost/benefit, Staff was tasked with identifying the risks involved with establishing an MEU to provide a strong "go or no go" recommendation to Council. The City of Chula Vista Municipal Energy Utility Feasibility Analysis (MEU Report) is the result of this effort. The MEU Report evaluates initial facility acquisition costs and provides various business models to rigorously test the economics of City ownership and operation of an energy utility. This agenda statement is a summary of the process used to implement the Council's direction. It also summarizes the recommendations of the City's consultant team and identifies differences in their report from the peer review comments.

When Staff negotiated its most recent SDG&E franchise agreement, the term was limited to 5 years because of the uncertainty of deregulation and the volatility of the energy market. That volatility still exists and as a result, some issues identified by the consultants have been overtaken by events, and others are still awaiting the adoption of implementing rules and regulations by the California Public Utilities Commission (CPUC).

Finally, this report provides Council with a comparative analysis of the recommended

MEU business models and the proposed franchise agreement with SDG&E. The intent of this analysis is to outline for Council the cost benefit of the proposed franchise with SDG&E to the implementation of an MEU business model. It is important to note that these options are not necessarily mutually exclusive. In fact, if Council implements one or more of the report recommendations, it is likely that the City will continue to have a long term energy relationship with SDG&E in some form.

DISCUSSION:

SDG&E is the San Diego region's energy service provider. SDG&E is a business unit of SEMPRA Energy (SEMPRA) a national Fortune 500 energy services holding company headquartered in downtown San Diego. SEMPRA (SRE) is a publicly traded company with a market capitalization of approximately $7.3 billion dollars. SEMPRA's annual revenue from SDG&E is approximately $1 billion dollars. SDG&E services San Diego and southern Orange counties and 25 cities. SDG&E is the investor owned utility that provides energy services to the City of Chula Vista. Chula Vista is approximately 9% of SDG&E's total natural gas and electricity market and makes up approximately 7% of all energy meters. SDG&E's five-year average - 1999 to 2003 - annual gross receipts from Chula Vista is approximately $100 million dollars.

In December 2002, SDG&E submitted a request to the CPUC to increase annual natural gas and electricity service wide rates by at least $100 million. This matter is currently under a settlement proposal before the Commission to limit the rate increase. The City Council directed Staff to intervene in the proceedings and contest the settlement agreement. The City's points against the proposed settlement are:

1. The proposed settlement would implicitly accept the form and detail of the initial "cost of service" filing in lieu of a general rate case. A general rate case establishes what the California Public Utilities Commission refers to as "revenue requirements," and has the effect of setting the basis for rates for up to five years. General rate cases have historically provided greater detail and opportunity for ratepayers and their advocates to review the facts behind revenue requests than the current "cost of service," filing provides. The SDG&E cost of service filing and the record developed in hearing does not support a settlement that could establish rates for five years;

2. The opponents to the proposed settlement are making the case that Sempra and its affiliates (SDG&E, Southern California Gas Company), has not passed on the savings that were projected and required to be passed. The opponents are also making the case that this settlement blends the costs between Sempra's affiliates in a manner that will make it unlikely, if not impossible to identify and pass those required savings on to rate payers in the future, and that without these savings the settlement establishes a higher base line for future cost of service or general rate case filings.

3. The Settlement continues a long history of very high utility earnings for SDG&E while providing no rate relief for SDG&E customers;

4. The Settlement tacitly assumes continuation of questionable capital investments and utility programs such as the design, location and timing of transmission projects, the management of energy conservation funds and other projects strongly opposed by local interests;

5. The Settlement rejects the majority of revenue requirement adjustments raised by local interests such as the City of Chula Vista, the Utility Consumer's Action Network (UCAN), and Federal Energy Administration (FEA) which represents the Military and other federal agencies); and

6. The Settlement ignores the negative impacts of SDG&E's rates on San Diego County.

In comparison, the CPUC approved reduced rates for ratepayers submitted by the other two major Utility service areas in California. Southern California Edison (SCE) rates were reduced by $1.2 Billion in July 2003 effective August 2003 and Pacific Gas and Electric (PG&E) rates were reduced by $783 million in February 2004 effective March 2004.

The high and ever increasing cost of energy in the SDG&E service area places the region and the City at a commercial disadvantage as compared to the rest of the state and most of the United States. The California Energy Commission is projecting that SDG&E's average electricity rates will be the highest in California for the next decade. Department of Energy data for 2002 indicate that California has the third highest rates in the nation only behind the cost of energy in New York and Hawaii. A lack of adequate energy generation and transmission infrastructure in its service territory also contributes to SDG&E's high cost of service.

The San Diego Regional Energy Office (SDREO) conducted the 'Regional Energy Infrastructure Study' (REIS) in 2001/2002 and concluded that the current state of SDG&E's energy infrastructure is in dire need of enhancement. The REIS recommends adding more native generation, repowering the plants at South Bay and Encina, and installation of additional "local" transmission by 2005/2006 to prevent a recurrence of the energy crisis that occurred in 2000/2001.

Consultant Selection Process

Notwithstanding its efforts in statewide and regional energy issues, and having accomplished many of the recommendations of the City's Energy Strategy, the City Council directed Staff to pursue the feasibility of a City MEU. Staff immediately began to develop a Request for Proposal (RFP) to conduct the feasibility study.

Soon after these efforts began, an unsolicited proposal from Edison Utility Services representatives (now ENCO) - an MEU design/build operator - presented a revenue sharing proposal for an "electricity only" Greenfield Development project in undeveloped areas of the City. In a Greenfield Development MEU, the City would own and operate electric distribution systems, set rates and supply energy to customers. Under the proposal, ENCO would finance, construct and operate the Greenfield Development MEU as a Third-Party service provider for the City. The revenue sharing mechanism of the proposal between ENCO and the City would be modeled on a sliding scale. The distribution of the benefits and risks are dependent on the level of investment and risk accepted respectively by ENCO and the City for infrastructure use not already funded by developers. Energy supply, operation and maintenance costs would be recovered through rates.

At the same time, ChevronTexaco (Chevron), a company similar to ENCO, also approached City Staff and presented their “electricity only” Greenfield Development MEU program. Chevron reviewed and commented on the City’s scope of work for the feasibility study. Chevron then proposed to conduct the feasibility study “at no cost” for the City.

Based on a series of meetings with ENCO & Chevron, Staff was convinced that the “greenfield” proposal represented a sound business opportunity worthy of serious consideration. City Staff sought SDG&E’s input about the proposed MEU feasibility study. Staff also solicited SDG&E’s input regarding the draft scope of work for the RFP. Based on SDG&E’s input, Staff agreed that the better approach for the City would be to select the feasibility consultant through an open and competitive process that would consider multiple options, not just the one being proposed. Staff also incorporated SDG&E recommendations in the scope of work. Based on SDG&E’s input and the City’s shared concerns about objectivity, Staff declined the ENCO and Chevron proposals and Chevron’s offer to conduct the feasibility study at no charge. **Shortly thereafter SDG&E unilaterally chose to withdraw from participation with City Staff in the development and implementation of the RFP process.**

On December 20, 2002 Staff released an RFP to study the costs and benefits of implementing various possible MEU businesses, including owning and operating all or portions of the local distribution system. The RFP was released to over 60 national legal, energy and engineering firms. SEMPRA (SDG&E’s parent company) and three firms recommended by SDG&E (EES Consulting, Black and Veatch, and R.W. Beck, which ultimately was used as one of the peer review consultants) were among the companies provided with the RFP.

On January 9, 2003 Staff conducted a pre-bid conference attended by about 20 representatives from 15 firms. Because SEMPRA, not SDG&E, was on the mailing list, Staff delivered an RFP package to SDG&E one day prior to the meeting. SDG&E had participated in the development of the RFP scope of work well in advance of the meeting and an SDG&E representative was able to attend the meeting. Responses to questions received at the pre-bid conference and prior to January 17 were distributed to potential bidders on January 24. On February 7, Staff received proposals from the following nine firms: (no proposal was received from SDG&E)

- Alliant
- Astrum Utility
- Black and Veatch
- GDS Associates
- McDonald Partners
- Milbank Tweed

- Duncan/Navigant
- EES Consulting
- R.W Beck

On February 21, 2003, after a thorough review of the proposals from the nine firms, an internal selection committee composed of City Staff: Sid Morris, Glen Googins, Michael Meacham, Willie Gaters, Maria Kachadoorian, and Dave Byers unanimously selected the following top five firms for initial interviews in March 2003:

- Alliant
- Black and Veatch
- Duncan/Navigant
- GDS Associates
- R.W Beck

On March 5 and 6, 2003 an interview panel composed of the internal section committee, Bill Carnahan, Executive Director of Southern California Public Power Authority and Dave Wright, City of Riverside Municipal Utility Assistant Director interviewed the top five firms and selected the following top two firms for final interviews, follow-up questions and referral background checks:

- Duncan/Navigant
- R.W Beck

On March 14, 2003 the internal section committee (again with assistance from Mr. Carnahan and Mr. Wright) unanimously agreed to recommend Navigant Consulting, Inc., Duncan, Weinberg, Genzer & Pembroke and McCarthy & Berlin (collectively referred to as “Duncan/Navigant”) for Council consideration. On March 25, 2003 Staff presented a report on the RFP process and Staff’s recommended firm to Council (see Attachment 8). Duncan/Navigant was selected based upon the following criteria:

- The proposal as originally submitted was complete in its approach, addressing all of the major scope of work components;
- The consultant team Duncan/Navigant has a longstanding working relationship with one another, and past efforts by this group reflected extensive, detailed research in addressing clients’ concerns;
- Duncan/Navigant was most knowledgeable in identifying the South Bay Power Plant and other possible local generation options as a potential key opportunity for a Chula Vista MEU;
- Duncan/Navigant was most clear in its intent and ability to provide the City with an “actionable intelligence”;
- The consultant had relevant California experience including extensive work with California regulatory agencies;
- The consultant has demonstrated the experience and ability to deliver a report on time, within budget and according to established criteria;
- The consultant team exhibited the best overall breadth and depth of energy industry sophistication; and
- Duncan/Navigant offered the greatest number of hours applied to the task, approaching, in many respects, a phase II level of analysis.

In April 2003, the City contracted with Duncan/Navigant.

MEU Models Study Process

Objective of the MEU Feasibility Study

Navigant/Duncan was tasked to answer the question: Is it viable for the City of Chula Vista to pursue the implementation of MEU business? If so, what form of MEU business?

Duncan/Navigant identified and evaluated the financial, legal and technical feasibility of various MEU business models and analyzed each MEU business model's merits relative to the objectives listed below:

- Establishes reliable and stable electricity and natural gas supply and maintains the highest level of customer service.
- Identifies a viable business model that benefits the City's time and investment.
- Ensures an environmental advantage for City residents, businesses and the region.
- Results in a citywide distribution of MEU benefits.
- Enables the utilization of the MEU as an economic development tool to retain and attract businesses.
- Enhances Chula Vista's vision to continue as a vibrant community in the region.

Report Financial, Legal, and Technical Feasibility Analysis Methodology

A general description of Duncan/Navigant's methodology to analyze the financial, legal and technical feasibility of an MEU business models is described below:

Legal Feasibility Analysis

Duncan/Navigant identified and analyzed the alternatives available to the City under applicable federal laws, state and local regulations applicable to municipal energy utility formation and operation. Duncan/Navigant analyzed the potential costs of acquiring SDG&E's distribution and other facilities, by voluntary sale or condemnation, and the City's potential obligation to pay SDG&E's "stranded costs" (reimbursable capital investments). Duncan/Navigant also analyzed and addressed applicable legal requirements, regulatory approvals, and applicable laws and regulations governing the acquisition and delivery of electric and gas supplies to a City MEU.

Financial Feasibility Analysis

Duncan/Navigant determined the costs, benefits and feasibility of implementing selected utility structure business models by incorporating prospective loads, load shapes, existing (SDG&E) rates, energy resource supply portfolios, capital costs, debt service, operation and maintenance cost projections, exit fees, in-lieu tax payments and other inputs in Duncan/Navigant's proprietary "Utility Feasibility and Cost of Service" model (UFCOS). The UFCOS Model then generates detailed reports that demonstrate the revenues that can be generated by each integrated business model over time. The benchmark for financial composition is the same service provided by SDG&E using existing and projected SDG&E rates. The UFCOS Model output reports include cost-of-service requirements, revenue projections and forms the bases for preliminary rate design. The UFCOS platform allowed for iterative sensitivity analyses, with variable inputs regarding forward energy prices, fuel costs and asset valuation alternatives.

Technical Feasibility Analysis

For the Greenfield and MDU alternative, Duncan/Navigant conducted a preliminary appraisal of the electric and gas utility facilities now owned and operated by SDG&E in the City, and identified facilities necessary for the City to operate each feasible MEU business model. Duncan/Navigant analyzed the system modifications necessary to separate the MEU gas and electric distribution systems from SDG&E and the contractual arrangements (including borderline agreements, interconnection agreements, and power and gas supply agreements) necessary for the operation of a distribution system. For all business models including CCA, Duncan/Navigant also developed and provides an analysis of all available and economically feasible power and gas supply alternatives open to the MEU, including purchased power, the availability of Federal preference power, MEU-owned generation, and available gas and pipeline resources, together with an estimate of the cost of power and gas supply and a comparison of such costs with the current cost of power, energy, and gas presently provided by SDG&E.

Utility Business Models and Alternatives

Identification of Utility Options

Duncan/Navigant analyzed five municipal energy utility business models and alternatives authorized under federal and State law. Duncan/Navigant identified the following business models that could legally facilitate Chula Vista's entry into the MEU business:

- Community Choice Aggregation (CCA): electricity;
- "Greenfield municipalization" development (Greenfield): electricity immediately with the potential for gas
- Municipalization under a city electric utility department format, eventually leading to a Municipal Distribution Utility (MDU) system;
- Participation in a joint powers agency (JPA); and
- Municipalization under a Municipal Utility District format (MUD).

As an MEU, the City could develop or acquire generation resources, and/or purchase power to meet the City's load requirements. A MEU would position the City to provide energy to the community by replacing SDG&E services in whole or in part. A MEU would ultimately provide the City with a public utility structure to protect the Chula Vista community from unreasonably high-energy costs, and unreliable energy supply, while allowing the community to locally control its energy future.

Duncan/Navigant's legal review of the business models identified three basic models and one derivative that merited further financial and technical review:

- Community Choice Aggregation (CCA) (Target Implementation Jan. 2006)
- Greenfield Development – Immediate Implementation
- A combination of CCA and Greenfield Development (Target Implementation Jan. 2008)
- Municipal Distribution Utility (reconsideration in 2010)

Duncan/Navigant has recommended that the complexities of organizing an MUD and coordinating efforts with other local governments or entities would add unnecessary complications and delay an immediate implementation. However, Duncan/Navigant did recommend that these models should be revisited at a later date.

Financial and Technical Feasibility of MEU Business Models and Alternatives

Financial analysis of the selected MEU business models were "run" for a study period of 18 years (2006 to 2023). A summary of the MEU business models evaluated by Duncan/Navigant includes key elements critical for a viable MEU business. These elements are:

- Key Assumptions
- Supply Strategy
- Start-Up Costs and Operational Issues
- Risks
- Benefits
- Pro-Forma Results
- Recommendations
- Financing Options
- Next Steps/Implementation

MEU Business Model Discussion

Community Choice Aggregation

The City has an option to serve as a community load aggregator for electric power pursuant to Assembly Bill 117 - this is subject to the CPUC review of the City's Implementation Plan, the adoption and application of exit fees (a per kilovolt charge applied by the CPUC to recover the cost of the Department of Water Resources energy contracts, currently under discussion at the CPUC), and the implementation of final rules by the CPUC. The City is engaged in the CPUC proceeding to determine exit fees and final rules. A load aggregator is an entity that procures electric energy and/or natural gas for residents and businesses within a community. Under this business model, the City would not own the electric or gas distribution system within the City. Rather, it would procure electric power and/or natural gas, either through owning a generation facility, market purchases, or through a partner on behalf of the customers that choose to aggregate their load. As a CCA, the City would use SDG&E's distribution and transmission facilities to deliver electricity and/or natural gas to its customers. Notwithstanding the application of exit fees, Duncan/Navigant has identified CCA as a viable alternative for the delivery of energy.

Greenfield Development

Another viable option is a the implementation of a Greenfield project under the City's Municipal Utility status adopted by Council on June 5, 2001. Typically, this structure would include undeveloped acreage of land designated for an industrial park or new residential subdivisions. Duncan/Navigant has not identified any legal impediments to pursuing this MEU business model. Duncan/Navigant identified the Otay Ranch Area, Mid-Bayfront, and Sunbow planning areas as the sites primarily adaptable to a Greenfield project.

A Greenfield Development requires investment in distribution facilities to supply energy to previously undeveloped areas within the City of Chula Vista. The distribution system is typically planned and built in collaboration with the developers of the projects and much of the cost is borne by the developers. The consultant's feasibility analysis assumes a worst case, with these costs borne by the City. Even under this model, Duncan/Navigant has identified greenfields as warranting serious consideration. However, it is likely the City would use a model similar to the utility and require that the developer dedicate these facilities.

The MEU may need to fund and construct a substation, and if so, would have to interconnect to SDG&E's system in order to supply energy. The MEU would also need to develop the distribution system configuration (underground) lines, appurtenances, and service extensions, as well as make arrangements for appropriate meters and related customer service functions. Notwithstanding these planning and phasing requirements, these costs are included in the Greenfield business model.

Community Choice Aggregation/Greenfield Development Combined

This business model represents the derivative of the main options. The City would implement both the CCA and Greenfield models simultaneously and administer and operate the two programs using City Staff and/or an outside Third-Party service provider to oversee operations. The Duncan/Navigant report indicates that the City enhances the near term economic benefits by forming a CCA program and simultaneously pursuing and implementing Greenfield Development programs.

Municipal Distribution Utility

As defined by Duncan/Navigant, an MDU is a public agency that acquires some or all of the existing utility infrastructure within its jurisdiction and uses it to provide energy services previously provided by the incumbent utility. The Duncan/Navigant Report states that there are approximately 38 public agencies that currently provide electric utility services to communities in California, servicing approximately 25% of the state's total electric load. With this utility structure, the City could acquire some or all of SDG&E's electric and/or gas distribution system by a negotiated sale or condemnation. Under this option, MDU services could be provided by a City utility department, or contracted out. The City Council, or a separate board appointed by the Council, would oversee the MDU operations. Duncan/Navigant recommends that the MDU model be pursued only after at least 2 years of successful CCA and/or CCA/Greenfield operation.

Summary of Fiscal Implications

The Duncan/Navigant Feasibility Study Recommends Three Viable City MEU Business Models

The findings of the feasibility study indicate that, pending the outcome of CCA rulemaking by the PUC, it would be legally, financially and technically feasible for the City to implement "electricity only" CCA & CCA/Greenfield operation MEU business models beginning in 2006. Although the viability of each MEU business model works with contracted/purchased electricity, each MEU business model is enhanced with City ownership of generation capacity located within the City. Locally owned generation will reduce supply cost and transmission congestion charges borne by the community.

Duncan/Navigant is only recommending an MDU for further consideration after 2-4 years of successful operation of a CCA or CCA/Greenfield MEU. The Report does not recommend a natural gas MEU at this time, but suggests that it may become viable depending on price fluctuations and the development of lower cost LNG opportunities south of the U.S./Mexican border.

Duncan/Navigant projects that, over an 18-year period, an electric CCA supplied with contract power would generate revenues of $4.78 million annually ($86 M) whereas an electric CCA supplied with local generation would generate annual revenues of $13.56 million ($224 M).

In a combined electric CCA/Greenfield, a community aggregates energy for the community over the Utility's infrastructure and develops City owned energy infrastructure in undeveloped parts of the City. An electric CCA/Greenfield supplied with contract power would generate annual revenues of $9.45 million ($170 M) whereas an electric CCA/Greenfield supplied with local generation would generate annual revenues of $19.5 million ($351 M).

In an electric only MDU, the City would negotiate for the purchase of the Utility owned electric distribution infrastructure. A MDU supplied with local generation would generate annual revenues of $18.3 million ($329 M). The table below provides a side-by-side overview of the viable MEU business models.

Summary of MEU Business models, Startup Cost and Projected Revenues

Business model	Supply Strategy	Pre-implementation Startup Cost	Revenues $
CCA	Contract	225 thousand	86 million
CCA	Generation	225 thousand	244 million
CCA/Greenfield	Contract	13.8 million	170 million
CCA/Greenfield	Generation	13.8 million	351 million
MDU	Generation	185 million	329 million
Generation		78 million	

Potential MEU Benefits

The MEU business models identified above would fulfill most of the City's community-wide energy objectives and would provide the following benefits over time:

Local Control of City's Energy Future

- Establish a local Municipal Utility structure that's only focus is on service and delivering value to the community, not profit to shareholders.
- Establish a local Municipal Utility that is accountable to local ratepayers, not shareholders, state and federal regulators.
- Establish reliable electricity and natural gas supply that reduces or eliminates scheduled brown outs and maintains the highest level of customer service.
- Stabilize consumer rates.
- Establish land use guidelines for power lines and utility boxes that put local quality of life issues first.
- Enhanced Control of Local Conservation Funds to:
    - Ensure an environmental advantage for City residents and businesses,
    - Invest the $3,000,000 already collected from Chula Vista ratepayers each year to produce real savings for current rate payers,
    - Establish better incentives for existing residents and businesses to invest in conservation and clean generation options,
    - Invest in a more environmentally sustainable energy future based on renewable sources that do not use fossil fuels,
- Invest in medium and long-term energy procurement and power generation strategies that reflect the City's commitment to a sustainable environment and cleaner air including;
    - CO_2 reduction, the prevention of global warming, and particulate reduction.

- Investment in energy procurement and generation, infrastructure and operational services that maintain existing jobs and create new quality jobs for local residents.

- Enable the utilization of the MEU as an economic development tool to retain and attract businesses

    - Establish better incentives that encourage developers to reduce costs through increased invest in conservation and clean generation for residential and commercial building using rate structures, infrastructure taxes and other means available.

- New city revenues at no increased cost to ratepayers

    - Equitably invest new revenues generated from an MEU business throughout the City in the form of enhanced existing services and/or new services.

- Enhance Chula Vista's vision to continue as a vibrant community in the region and a leader in environmental stewardship.

MEU Development Risks And Risk Management

If the City elects to proceed with an MEU business, it will face significant political, financial and legal risks. Most efforts to develop a locally controlled MEU have been met with aggressive public relations campaigns and legal challenges from the local Investor Owned Utility and utility trade associations. However, the Duncan/Navigant report suggests these risks can be managed and mitigated to the point where they are outweighed by the potential financial and environmental benefits to the community. The risks and costs involved in developing an MEU business model are summarized below.

<u>Political Risk</u>

SDG&E will likely wage a public relations campaign to stop the City's efforts. SDG&E attempted to stop the City of San Marcos from forming a Greenfield Utility by sponsoring a "citizens initiative opposing a Greenfield development. The San Diego Union Tribune reported that this matter was recently settled between SDG&E & San Marcos.

<u>Financial Risks</u>

As identified by Duncan/Navigant

MEU Business Start-up Costs are Substantial

- CCA: $225,000
- CCA/Greenfield: $13.8 million
- MDU: $185 million

If the MEU business fails, some or all of these costs might not be recovered. Notwithstanding the risks, the Duncan/Navigant report points out the potential upside is equally significant:

- Reliable and consistent supply
- The reinvestment of saving into City services as opposed to going to shareholder profits
- Local planning and control compared with decision making by a state agency in San Francisco and a for profit private corporation
- Economic development and business development opportunities

Also, as Duncan/Navigant points out further mitigation is achieved through:

- The phasing of facilities commensurate with need.
- The concurrent implementation of CCA/Greenfield, enabling the City to secure power at more competitive rates due to cost effective load factors.
- Outsourcing operations and maintenance.
- The installation of the electric distribution infrastructure by local developers. (Even if this cost is absorbed by the developers, there are still potential savings opportunities for them over the costs and charges they currently pay to SDG&E.)
- The inherent price advantage Municipal utilities have over IOUs because they are not motivated by profits for shareholders.

Volatile Procurement Costs

The cost to acquire or generate electricity may fluctuate dramatically. Some of these costs might not be recoverable in rates (and thus may become City costs), or if passed on to the ratepayer, may result in volatile energy prices in Chula Vista.

Mitigating Factors

Possibly the most notable factor is that during the energy crisis, Municipal Utilities did not suffer the price fluctuations encountered, and in some cases, created by the utility industry. However, because Chula Vista is not an established public utility, it will be critical to insure that the City's energy,, portfolio is balanced and minimizes market fluctuations and manipulation.

Legal Risks

Significant legal costs may be incurred defending the MEU against legal challenges to its validity, or claims for damages caused by MEU business operations.

Mitigating Factors

The Duncan/Navigant reports that there are inherent benefits and advantages to public ownership of the utility system, as noted previously; the State's publicly owned utilities were protected from dramatic increases in rates. Although some increases occurred, they were not on the same magnitude as those experienced by investor-owned utility customers. In fact, many public utilities made significant profits on the sale of energy, to those outside their service area, during the energy crisis and a few have been investigated based on those profits.

Legal/Regulatory Risks

- SDG&E's sponsored lawsuits may defeat, or make more costly, any attempted MEU business.
- Legislative changes and CPUC proceedings may routinely "change the rules" for MEU business operations in ways that increase costs and/or affect local service control or quality.
- CCA rules are not finalized and attempts by the IOUs to influence the PUC rule making process have not been acceptable.

Mitigating Factors

The report recommendations proposed by Duncan/Navigant are very conservative and even based on a worst-case scenario still has a positive cost/benefit. The earlier a public agency establishes itself as an operating public agency, the sooner the agency is "grand fathered" in under the then current regulations. Additionally, the existing approximately 38 California public utilities, representing approximately 25% of the state's energy load, are collectively a formidable group that are likely to prevent any further erosion of public utility rights.

Independent Peer Reviews

Because the magnitude of this project and the potential risk/reward issues, Staff engaged independent third-party consultants to assess the conclusions and recommendations, findings and key assumptions in the feasibility study conducted by Duncan/Navigant. Peer reviewers assessed the projections for SDG&E's rates, power purchase costs and generation development costs used by Duncan/Navigant in the modeling Proformas to test the practical application of the feasibility study's assumptions, findings and recommendations. The independent consulting firms include R.W. Beck, Tabors, Caramanis & Associates and Crossborder Energy.

In general, the peer reviewers independently concluded that the feasibility study used very conservative assumptions and that Duncan/Navigant's analysis and recommendations were reasonable (please see Attachments 3, 4 and 5). Specifically:

R.W. Beck

R.W. Beck was retained to review and comment on the practical aspects of Duncan/Navigant's key assumptions, findings, conclusions and recommendations. R.W. Beck also evaluated critical components of the proformas prepared by Duncan/Navigant. These components included verifying the preciseness of the forecasts for power purchase costs (PPC), generation development costs and projected

SDG&E rates.

General Findings

- Using a discount rate of 10% for Net Present Value (“NPV”) calculations is high for a public entity. A discount rate of 6% to 7% would be more reasonable for the City. As the discount rate is decreased, savings to the City would increase.

- Exit fees seem high at the end of the study period. It is highly likely that exit fees within the SDG&E service area in particular will be lower relative to SCE and PG&E.

- The schedules for implementation are very optimistic. In each case, the schedule for implementation is more rapid than what is likely to occur, particularly if SDG&E decides to oppose the initiative. The long end of the range provided for implementation is what could reasonably be expected.

- Power plant costs for Chula Vista appear to be optimistic given R. W. Beck’s experience (Capital cost Duncan/Navigant estimates $600/kW vs. $850/kW). Costs can vary, depending on various conditions, including location, existing infrastructure, access to fuel, electrical transmission facilities, water supply, and emission restrictions. (Applies to CCA, CCA/Greenfield and MDU generation business models.)

- R.W. Beck also notes that its cost projection is based on an average and that Chula Vista’s unique features may save costs. Duncan/Navigant based its development costs on recent projects implemented by Navigant and on a California Energy Commission study titled Comparative Cost of California Central Station Electricity Generation Technologies – June 5, 2003.

- Based on this limited review, it appears that the methodology employed in the models used for this analysis is consistent with industry practice.

Community Choice Aggregation (CCA) Conclusions and Recommendations

- Something less than 100% participation should be assumed in the CCA Base Case analysis, since it is unlikely that no customers will opt out of the CCA program.

- There should be more consistency in power supply costs between SDG&E and Chula Vista (at a minimum in a sensitivity analysis).

Greenfield Development (GD) Conclusions

- There is a fairly long lead-time before GD becomes economic. Such a lengthy gap between implementation and savings creates risk to the City, particularly if the CCA or MDU options fail to be implemented.

- Developer funding of GD utility infrastructure should be equal to what would be contributed to SDG&E.

- There should be discussion of adverse reliability issues in GD due to limited ability or additional costs to loop feed to spot systems.

- The City should make certain that it will move forward and likely be successful with the implementation of either CCA and/or MDU before committing to this option.

- There should be discussion of adverse reliability issues in GD due to limited ability or additional costs to loop feed to spot systems.

- There should be more consistency in power supply costs between SDG&E and Chula Vista (at a minimum in a sensitivity analysis).

Municipal Distribution Utility (MDU)

- A cost of $15 million for acquisition fees, severance, and start-up is likely very low.

- Human Resource cost calculations assume fringe benefits of 15% – public agencies' fringe costs are generally closer to 40% or more.

- Human resource requirements appear to exclude purchasing, warehousing, buildings & ground, security, mail, legal, human resource, secretaries, and reception.

Crossborder Energy Assessment

Crossborder Energy was retained to provide a focused assessment of the Duncan/Navigant forecasts of the SDG&E electric and natural gas rates. Crossborder Energy was asked to validate the key assumptions in the forecast and to comment on the reasonableness of the forecast results. SDG&E rate forecasts are an important element of Duncan/Navigant's findings in the MEU report because they form the basis for assessing the MEU business model rate performance, and thus the projected savings relative to SDG&E.

- Electric Rate Projection Findings
  - Crossborder Energy's independent electric rate model produced results that were within 1% of Duncan/Navigant's electric rate projections; this validated Duncan/Navigant's projections.

- Natural Gas Rate Projection Findings
  - Crossborder Energy's independent natural gas rate model indicated that Duncan/Navigant's natural gas rate projections were conservative and suggested that we should keep an option open for further consideration of gas as an MEU business model.

Tabors, Caramanis and Associates Assessment

Tabors, Caramanis and Associates were retained to provide a focused assessment of the Duncan/Navigant forecasts for the Power Purchase Contracts and generation development costs.

- General Findings
    - Community Choice Aggregation rules are still pending formal adoption by the California Public Utilities Commission.
    - Other states have successfully implemented aggregation programs. Most successful programs are not based on full community programs.
    - The City could become a Co-op Purchasing Aggregator. This allows the City to purchase energy on behalf of customers but the City does not take title to power.
    - Aggregation alternatives should be explored in sufficient detail.
    - Outsourcing can reduce the City's risk in CCA business options and in Greenfield business options.
    - The City may want to obtain rights to low cost electricity through existing generation or projects that are in advanced development. The City would need to have the CCA or Greenfield in place before finalizing any deal, but contingency agreements could be pursued now.
    - The report does not adequately stress the volatility of the energy market. The City needs to be prepared to manage the risks associated with volatility and be ready to directly or indirectly manage the risks.
    - The report appropriately proposes a phased approach.

Peer Review Conclusions

Although each of the peer review consultants identified certain items that they may have done differently, used a different discount rate or a higher exit fee, they generally found the findings, assumptions and analysis by Duncan/Navigant supportable. In many cases the assumptions used by the peer review consultants were more aggressive and only made the MEU feasibility more attractive/viable. In those cases where the factors used by the peer review consultants had a significant impact on the numbers used by Duncan/Navigant, the outcome was not so significant as to change the stated recommendation.

Go/No-Go Recommendation

Duncan/Navigant evaluated a variety of MEU business models. Based on this analysis, it recommends that the City initially develop an MEU business by forming a Community Choice Aggregator (CCA). Thereafter, within two years, the City should combine CCA with a Greenfield utility business. Duncan/Navigant believes that with the experience gained from operating a CCA/Greenfield Development Utility the City could consider transition into a Municipal Distribution Utility (MDU) in four to six years. An MDU entails full ownership of all or part of the existing electric and gas delivery systems. The Duncan/Navigant report indicates that this gradual step-by-step growth will provide the

City with valuable experience in the MEU business before fully committing to operating a full distribution business. Duncan/Navigant believes that all the MEU business models (except MDU) would be viable immediately if supported by power purchase agreements (PPA). Duncan/Navigant believes that viability of all of the MEU business models would be enhanced including the MDU if supported by in-city electricity generation with a capacity of 130MW. Duncan/Navigant believes using a gradual approach ensures that the Council will have incremental decision points and that costs, benefits, risks and impacts to the City associated with each step can be evaluated, debated and understood before escalating the City's level of commitment.

The results of the Duncan/Navigant feasibility study demonstrate that the City's unique characteristic and the projected financial benefits and other local benefits from developing an electricity utility business would outweigh the legal, financial and technical risks. In other words, based on the results of the feasibility study, it is financially, legally and technically feasible for the City to implement an "electricity utility" business subject to the adoption of final CCA regulations.

The Duncan/Navigant feasibility study illustrates that each of the recommended MEU business models are viable as stand-alone endeavors. To maximize benefits of the business models, the consultants recommend that the City concurrently pursue the implementation of a CCA/Greenfield MEU by 2006. Specifically, that CCA be implemented immediately, subject to the PUC approval of the City's implementation plan or adoption of pending regulations, and that Greenfield development be pursued within two years and combined with the CCA. The consultant's also recommend that the City reconsider a natural gas service and Citywide MDU beginning in 2010 after the City has gained experience in operating an electric CCA/Greenfield MEU. The consultant's also recommend that the City develop ownership of generation capacity to enhance benefits from the proposed MEU businesses by 2010.

A caution that needs to be highlighted is that there are critical regulatory issues that have yet to be decided and that will have a major impact on the final policy action by the City Council. The California Public Utilities Commission (CPUC) is currently reviewing costs related to exit fees, municipal departing loads and the regulations for implementing CCA. Although costs related to exit fees and municipal departing loads have been incorporated into the MEU business proformas, these issues and the regulations for CCA need to be fully resolved before the City commits to forming a CCA-MEU business. Notwithstanding, the City has and should continue to engage in developing and positioning itself to forming an MEU business prior to a final ruling from the CPUC on these matters.

Summary of SDG&E Franchise Agreement

As noted previously, this report provides an analysis of the consultant's MEU business model recommendations compared to the implementation of a franchise agreement with SDG&E. This section will outline the status and components of an agreement with the Utility.

Franchise Description

Ordinance Nos. 2746 and 2747 adopted September 15, 1998 - Franchise Agreement - grants SDG&E the right to locate electricity and natural gas distribution systems in City "right-of-way" for a fee and other negotiated benefits. Under the Franchise, SDG&E has a "non-exclusive" grant to distribute electricity and natural gas citywide to residents and businesses. The Franchise Agreement expired on expired in June 30, 2003. The existing terms and conditions of the expired franchise agreement are continuing on a month-to-month basis.

Franchise Payment

The City receives a franchise fee of 1.1% of gross annual receipts for electricity and 2.0% of gross annual receipts for natural gas within the limits of the City. Other negotiated benefits include transacting "Industrial Development Bonds" for SDG&E capital projects. Under Rule 20A, SDG&E also allocates funds to underground aboveground electric distribution lines based on priorities set by the City. These funds are retained and managed directly by SDG&E. The chart below shows actual franchise fee revenues from 1999 to 2003 and projected franchise fee revenues from 2004 to 2005 and 2006 to 2023. Projected Franchise Fees are based on "revenue requirements" and franchise fees modeled in pro-formats prepared by Duncan/Navigant.

Actual Franchise Fee Revenues From 1999 to 2003

Year	Electricity ($)	Natural Gas ($)	Total
1998	$663,907	$408,156	$1,072,063
1999	$723,636	$1,014,008	$1,737,644
2000	$730,334	$2,586,932	$3,317,266
2001	$1,025,938	$5,249,096	$6,275,034
2002	$709,553	$488,844	$1,198,397
2003	$774,303	$654,799	$1,429,102

Projected Franchise Fee Revenues From 2004 to 2005

Year	Electricity ($)	Natural Gas ($)	Total
2004	$925,682	$681,233	$1,606,915
2005	$948,824	$689,274	$1,638,098

Projected Franchise Fee Revenues From 2006 to 2023			
Year	**Electricity ($)**	**Natural Gas ($)**	**Total**
2006	$972,544	$709,487	$1,682,031
2007	$996,858	$649,888	$1,646,746
2008	$1,021,779	$678,964	$1,700,744
2009	$1,047,324	$857,963	$1,905,287
2010	$1,073,507	$885,203	$1,958,710
2011	$1,100,344	$905,022	$2,005,366
2012	$1,127,853	$924,482	$2,052,335
2013	$1,156,049	$937,995	$2,094,044
2014	$1,184,951	$955,994	$2,140,944
2015	$1,214,574	$978,468	$2,193,043
2016	$1,244,939	$989,004	$2,233,943
2017	$1,276,062	$1,001,924	$2,277,986
2018	$1,307,964	$1,030,510	$2,338,474
2019	$1,340,663	$1,055,154	$2,395,816
2020	$1,374,179	$1,077,923	$2,452,102
2021	$1,408,534	$1,103,840	$2,512,374
2022	$1,443,747	$1,133,173	$2,576,920
2023	$1,479,841	$1,145,509	$2,625,350
Total	$21,771,712	$17,020,502	**$38,792,214**

The total projected nominal revenue from franchise fees from 2006 to 2023 is approximately $38.8 million. Additional revenues are realized if SDG&E refunds existing bonds to realize lower interest rates. The City is paid 25 basis points for issuing the bonds on behalf of SDG&E.

<u>Status of Franchise Negotiations</u>

SDG&E has notified the City of their intention to reduce the City's undergrounding allocation as well as other negotiated benefits if a formal Franchise Agreement is not Staff believes that SDG&E has no basis for unilaterally reducing any benefits afforded the City under the current expired franchise.

Staff is in on-going discussions with SDG&E negotiators to reach terms and conditions for a Franchise Agreement that is mutually acceptable to both the City and SDG&E. Staff cannot provide a definitive schedule to reach a conclusion to the negotiations at this time.

Although Staff had intended to provide the City Council with a comparative analysis of the benefits of an MEU versus a Utility Franchise Agreement, it cannot be completed due to the lack of a franchise agreement proposal by SDG&E. Over the course of negotiations, the City has provided SDG&E with a menu of options it considers important to a franchise agreement. SDG&E subsequently requested more detail to clarify each of the options, which the City provided. The City's offer was prepared in the menu fashion to provide greatest possible flexibility and allow SDG&E to select those items that best met SDG&E's corporate guidelines for entering into a franchise agreement, and to enhance the opportunity for a successful negotiation. After waiting some time without a comparable formal or written counter proposal, the City then submitted another offer, "back to back" without receiving a counter offer from SDG&E and in a manner inconsistent with normal negotiating protocol. This offer reduced the scope of the menu but retained those elements critical to an agreement. This offer is still pending with no response. In fact, the only recent offer received from SDG&E could be considered regressive. It recommended an excessive term of 55 years, with a reduction in the rule 20A Undergrounding allocation and no other appreciable enhancements.

Due to the extended nature of these negotiations, and the lack of an agreement with SDG&E, Staff recommends the timely consideration of the MEU analysis and recommendations.

City's MEU Business Model Options and Staff Recommendation

Advantage of Municipal Utilities Over For Profit Utilities

The Duncan/Navigant report points out that municipal utilities have an inherent price advantage over Utilities because the municipal utility is not motivated to produce profits for shareholders but value for their residents and businesses. Public utilities are permitted to set rates which cover both capital and operating expenses, fund utility reserve accounts, in-lieu-of-tax payments to local governments, and other worthy public works projects. In addition, the public utility has access to tax-exempt financing for many capital expenditures. These key components provide the City with a significant advantage regarding retail electricity rates as compared to remaining a full-requirement customer of SDG&E.

Chula Vista Characteristics That Make It A Good Candidate For An MEU

Chula Vista's continued development within western Chula Vista, the mid Bayfront and the eastern territories offers significant employment opportunities through new businesses locating in this area. Energy costs can be an important consideration in an employer's site selection. Electric rates in California are expected to remain high. Current energy costs in the SDG&E service area are not competitive with other areas. Comparatively, the SDG&E service area has the highest energy rates in California (for example, the City of Anaheim advertised having the lowest electric rates in Orange County.) A MEU opens up the opportunity to provide the Chula Vista community with increased reliability and access to lower cost energy.

Size and Growth:

- Chula Vista is the seventh fastest growing City in the nation and expects to add a minimum of 15,000 equivalent dwelling units, several million square feet of commercial and industrial space and a future major university on 500 acres. At its current size, Chula Vista would rank in the top 20 out of the approximately 38 California public utilities based on sales, and the top 11 out of 38 based on customer base.

- Acquiring title to new energy infrastructure in new development could lower the cost of development for developers and add valuable assets to the City's portfolio.

Tax Exempt Financing:

- Chula Vista can use tax-free financing for new energy infrastructure; this will lower the relative cost of service.

Existing Energy Infrastructure:

- Chula Vista is a host to major energy infrastructure:
  - A 706 MW base load power plant that is being considered for repowering.
  - Adjacent to a 4 MW landfill power plant with potential expansion to 8 MW over the next several years.
  - Major regional natural gas and electricity distribution and transmission lines throughout the City.

Additionally, according to the California Municipal Utility Association (CMUA) approximately 38 publicly owned electric and gas utilities continue to successfully operate in California. These public utilities have provided energy to nearly 3 million customers, or 25 percent of the electric load at a cost that is on average 15% to 40% less than their investor owned counterparts over the past several years. The public utilities in California identified by the CMUA include:

Alameda (1887)*	Imperial Irrigation District	Riverside (1895)
Anaheim (1894)	Lassen MUD (1986)	Roseville
Anza	Lodi	Sacramento MUD (1947)
Azusa (1898)	Lompoc	Shasta Lake (1993)
Banning	LA DWP	Silicon Valley Electric (1896)
Biggs	Long Beach	Surprise Valley
Burbank (1913)	Merced Irrigation District (1996)	Toulumne County
Coalinga	Modesto Irrigation District	Trinity County PUD (1982)
Colton (1895)	Needles (1983)	Truckee Donner PUD
Glendale	Palo Alto	Turlock Irrigation District
Gridley	Pasadena	Ukiah (1897)
Healdsburg	Plumas-Sierra	Vernon (1989)
Hetch Hetchy W&P	Redding	

*Reflects the year in which the public utility was established. Staff was not able to determine this information for every utility.

Conclusion

The consultants have conducted a comprehensive analysis of the MEU business options available to the City, which has subsequently undergone a comprehensive peer review. The feasibility study recommends, and the peer review process supports, the implementation of a CCA and Greenfield MEU in order for the City to begin to gain control of it's energy future and meet the objectives stated earlier in this report. and repeated below:

Local Control of City's Energy Future

- Establish a local Municipal Utility structure that's only focus is on service and delivering value to the community, not profit to shareholders.

- Establish a local Municipal Utility that is accountable to local ratepayers, not shareholders, state and federal regulators.

- Establish reliable electricity and natural gas supply that reduces or eliminates scheduled brown outs and maintains the highest level of customer service.

- Establish land use guidelines for power lines and utility boxes that put local quality of life issues first.

- Stabilize consumer rates.

- Enhanced Control of Local Conservation Funds to:

    - Ensure an environmental advantage for City residents and businesses,
    - Invest the $3,000,000 already collected from Chula Vista ratepayers each year to produce real savings for current rate payers,
    - Establish better incentives for existing residents and businesses to invest in conservation and clean generation options,
    - Invest in a more environmentally sustainable energy future based on renewable sources that do not use fossil fuels,

- Invest in medium and long-term energy procurement and power generation strategies that reflect the City's commitment to a sustainable environment and cleaner air including;

    - CO_2 reduction, the prevention of global warming, and particulate reduction.

- Investment in energy procurement and generation, infrastructure and operational services that maintain existing jobs and create new quality jobs for local residents.

- Enable the utilization of the MEU as an economic development tool to retain and attract businesses

  - Establish better incentives that encourage developers to reduce costs through increased invest in conservation and clean generation for residential and commercial building using rate structures, infrastructure taxes and other means available.

- New city revenues at no increased cost to ratepayers

  - Equitably invest new revenues generated from an MEU business throughout the City in the form of enhanced existing services and/or new services.

- Enhance Chula Vista's vision to continue as a vibrant community in the region and a leader in environmental stewardship.

In addition, other factors have come to light, which impact Staff's evaluation of the findings and ultimate recommendations:

- Energy experts are predicting that the energy market is uncertain at best and predicted to worsen unless additional infrastructure is added in the region.

- The Regional Energy Infrastructure Study (REIS) commissioned by SANDAG indicates that unless additional energy infrastructure in added in the region to serve the region, another crises will occur by 2005. SDG&E in its 20-year resource plan reiterated that additional infrastructure was also needed to ensure rate stability and reliable supply. The REIS suggest that at least two new base load generation plants be added in addition to repowering of the existing power plants in the San Diego region. REIS also recommends that additional transmission lines be added to **connect local sources** and that a focus be placed on an increase in conservation to ensure adequate supply.

- The twenty year resource plan proposed by SDG&E to the PUC concentrates on the construction of two new generation facilities and significantly greater transmission capacity with the stated goal of reducing utility paid "reliability must run" (RMR) charges. This translates into the possible elimination of the existing South Bay and Encina Power Plants. The net result is a decrease in total local generation; an increase in dependency on local generation from a single source (SDG&E), greater reliance on energy transmitted from outside the region and reduced competition to facilitate lower rates. SDG&E's 20-year resource plan does not meet the intent or spirit of the regional goals established by the Regional Energy Infrastructure Study. A regional plan that SDG&E helped develop.

- In December 2002, SDG&E filed an application with the CPUC to increase the "revenue requirement," effectively increasing future service territory rates by $100,000,000 per year. This matter is pending a settlement agreement to increase annual rates, which is being contested by the City.

In short, the lack of energy infrastructure and ever increasing utility rates in the region will continue to erode Chula Vista's budget and any flexibility to provide new programs and better services. Based on the feasibility study, a City MEU business would be viable and could address the City's objectives, which have been mentioned previously.

Comparison of the MEU Business models with the SDG&E Franchise Agreement Benefits

As shown in the table below, a majority of the MEU business models are more financially favorable when compared to SDG&E's current "month-to-month" franchise arrangement. In most cases, the City could implement an MEU business model that would still allow SDG&E to retain their energy infrastructure and continue to provide benefits under a franchise agreement.

Comparison of MEU Business models and Franchise Benefits

Rank	MEU Business Model	Supply Strategy	Nominal Savings ($ Millions)	NPV of Savings ($ Millions)	Average Annual Savings (%)
1*	CCA/Greenfield	Generation	351	122	10%
2	MDU	Generation	329	109	9%
3*	CCA	Generation	244	90	8%
4*	CCA/Greenfield	Contracts	170	52	4%
5*	CCA	Contracts	86	28	2%
6*	Greenfield	Contracts	89	21	10%
7	MDU	Contracts	16	(12)	-1%
#	**Franchise**	**None**	**39**	**16**	**none**
*Franchise payments would continue under business models 1, 3, 4, 5 and 6 in areas served by SDG&E with the exception of Greenfield areas served by the City.					

The comparison above provides a financial basis that further supports the implementation of a City MEU business model. Although a franchise agreement does provide considerable resources that contribute to the City's ability to enhance public services, it has not produced the kind of potential benefits afforded other California public utilities, which are identified in the report under local control. It has not protected residents and businesses from exponential rate increases, it has not produced consistent conservation benefits that are commensurate with the amount of funds collected annually from local ratepayers and it has not produced the kind of economic development opportunities for Chula Vista businesses that Staff has asked for and identified in other communities.

Staff Recommendation

The MEU Report and peer review clearly indicate that the City can start and operate a feasible City MEU. The state of the energy market, the inherent risk involved with creating a new MEU business and the significant start-up costs associated with forming a new MEU operation are manageable risks that also represent opportunity that, over time, have been born out by approximately 38 public utilities that produce benefits for their respective communities at substantial savings for their ratepayers. The comparison of the MEU business models and the Franchise Agreement also demonstrate that the City could potentially implement a model that generates financial benefits to enhance City services, stabilizes rates for residents and businesses, mitigates risk by phasing different components of the MEU over time and allows an SDG&E franchise to continue for many years to come.

Political and legal challenges will present significant barriers and the level of their cooperation should determine how much Chula Vista can and should rely on a future partnership with SDG&E to provide energy services for Chula Vista ratepayers.

Staff ranked each business model relative to the associated risks and implementation potential based on the cost/benefit, risks and timeline associated with each MEU business model.

Summary of MEU Business models, Startup Cost and Projected Revenues

MEU Business Model	Risk	Benefits/ Savings $	Startup Cost $	Supply Strategy Capital Investment $	Supply Strategy	Calendar Year Start
CCA	Lowest	86 million	225 thousand		Contract	2006
CCA/ Greenfield	Mid-low	170 million	13.8 million		Contract	2006
CCA	Mid	244 million	225 thousand	78 million	Generation	2010
CCA/ Greenfield	Mid-hi	351 million	13.8 million	78 million	Generation	2010
MDU	Highest	329 million	185 million	78 million	Generation	2010

Based on a review of potential cost/benefits, risk and likelihood of implementation, Staff believes that the City should continue to pursue development of a City MEU business model to control the City's energy future.

Staff recommendations are included below, but Staff is not requesting that Council action be taken at this time on these recommendations. Staff is however, requesting that Council direct Staff to return to council on June 8, 2004 for go/no-go actions regarding the Municipal Energy Utility. At the June 8, 2004 meeting, Staff will recommend that Council direct Staff to implement City MEU business models as outlined below:

1. Direct Staff To Prepare Applicable Zoning And Permitting Ordinances That More Specifically Address Time And Placement Issues Regarding Energy Utility Infrastructure By Fall 2004.

2. Direct Staff to prepare a resolution that would, under its status as a Municipal Utility (Ordinance No. 2835, June 5, 2001) declare itself a Community Choice Aggregator.

3. Authorize Staff To Complete And Execute An Implementation Plan To Become A

Community Choice Aggregation Administrator.

4. Direct Staff To Return To Council With A Full Staffing Plan For Implementation Of The Greenfield Development And Community Choice Aggregation Programs and appropriate funds therefore.

5. Direct Staff To Appropriate $475,000 In Additional Funds To Continue To Implement The City's Energy Strategy, Plus The Cost For Additional Staff To Implement The Selected Municipal Energy Utility Business Models.

The adoption of the resolution before City Council today, does not require an appropriation and will not have an impact to the general fund. The items which Staff has proposed to bring back to City Council at the June 8, 2004 meeting would require an appropriation from the available fund balance of the General Fund:

Continue the work with the CPUC to develop viable regulations and exit fees for a Community Choice Aggregation (CCA) program (Outside Consultant Fees)	$250,000
Complete and submit an implementation plan to the CPUC for a Community Choice Aggregation Program Based on the estimates provided by Duncan/Navigant	$225,000
Total Funding Request Anticipated for June 8, 2004	$475,000

Once the City's CCA implementation plan is approved by the CPUC, Staff anticipates that it will return to Council for additional funds for the pre-development, power procurement and a Staffing plan to implement a MEU business model, should City Council chose to move forward.

FISCAL IMPACTS:

The City Council's approval of the recommendation contained in this resolution will not have an impact to the general fund. The action that Staff has outlined for consideration at the June 8, 2004 meeting would require an appropriation from the un-appropriated balance of the General Fund for an estimated $475,000.

ATTACHMENTS:

1. Peer Review Report - R.W. Beck
2. Peer Review Report - Crossborder Energy
3. Peer Review Report - Tabors, Caramanis and Associates
4. MEU Report - Executive Summary
5. MEU Report - Report
6. MEU Report - Appendices
7. March 25, 2003 City Council Agenda Statement